

## **The Organization of the Informal Venture Capital Market**

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Handbook of Research on Venture Capital, Hans Landstrom, ed., Edward Elgar

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### ***Policy Implications***

Public policy can play a role in facilitating the development of a vibrant and active angel market at a regional level and enhancing the flow of early stage equity capital to entrepreneurial ventures. Specifically, four levels of policy recommendations are offered: (i) linkages, (ii) research, (iii) education and (iv) monetary incentives. With respect to linkages, an active angel market requires the presence of innovators who develop the idea, entrepreneurs who form a business around the innovation and business angels who provide the capital to move the idea from the laboratory to the marketplace. While some, or all of these, are present in communities, it is important that the linkages between these groups be established and public policy can play a role in fostering and nurturing these linkages. Specifically, an active public policy to support the development of the business side of the innovation (the innovator to entrepreneur linkage) would support both an information clearing house for innovators and entrepreneurs to find each other and a sponsored venue for these meetings to take place. In addition, a physical location, such as an accelerator, would further the development of the innovator-entrepreneur interaction. To foster the growth of the business angel linkage with both the innovator and entrepreneur requires a pro-active public policy to facilitate, and act as a catalyst for, these interactions to take place. Also, since angel investing requires substantial screening of opportunities, public support of this screening function would assist business angels in their search for quality deals.

Public policy can also play a role in supporting research to increase the understanding of the changing nature of the angel market. The angel market is a myriad collection of angel portals and a difficult market to gain access to for research purposes. Research efforts in this context are labor intensive, costly and must be longitudinal in nature. Such an extensive and comprehensive research undertaking is beyond the purview and the resources of local governments and private sector firms. Research efforts of this magnitude are best supported through public policy agencies or a public/private sector partnership to provide the patient capital to design and undertake business angel research on a national scale. This research can assist governments in making informed policy decisions regarding the growth and sustainability of the business angel market.

Educational programs should be developed that target both the supply and demand. Namely, education directed to latent angels to assist in understanding the central mysteries of angel investing and for entrepreneurs to appreciate the requirements necessary to become investor ready. Successful educational programs would result in an increase in both available capital and quality deal flow. There exist some limited private sector initiatives in this area, such as the Power of Angel Investing in the US and Angel Academies in Europe. While private sector initiatives can play a limited role in

education, the public sector is uniquely positioned to marshal the appropriate individuals and garner the resources necessary to develop and implement a comprehensive education program that is available to all entrepreneurs and business angels at a subsidized price. The public sector, in combination with existing research and funded research projects, can assure the consistency of the educational content. In addition, public sector involvement and funding of educational programs will assure that the content is based on research studies and avoid the incidence of anecdote based training that occurs in a number of existing private sector programs.

Public policy monetary incentives should focus on enhancing the flow of early stage equity capital to entrepreneurial ventures. First, to increase a supply of start-up capital and to leverage existing angel resources, a pool of capital, the Archimedes Fund, needs to be created at a regional or national level. This Archimedes Fund would be the source of leverage for angel investors. The creation of a fund with a 3 to 1 leverage would both increase the available start-up capital and provide a form of downside risk protection for angel investors. As an example, in an investment of US\$1,000,000 the angel would provide US\$750,000 and draw US\$250,000 (3 to 1 match) from the Archimedes Fund. At the exit event, any capital gains would be redistributed to the Archimedes Fund, in the 3 to 1 ratio, for future investments. It is important to note that the Archimedes Fund is not a venture capital fund, but rather a matching fund for business angels. As such, management of the fund would be substantially less burdensome than a classic venture capital fund. It is important that the source of capital for the Archimedes Fund be corporate partners or governments and not individual investors, to enhance the creation, rather than the redistribution, of equity capital. An example of such a monetary initiative is the Scottish Enterprise Business Growth Fund and the Scottish Co-investment Fund. These two funds accounted for 7% of the total monies invested in Scottish early stage companies in 2004 and were represented in 55% of all the deals recorded (Don and Harrison 2006). In addition, the leverage effect of the Scottish Co-investment Fund is substantial, with the average business angel deal size in 2004 increasing from 179 pounds sterling to 475 pounds sterling when business angels coinvested with the fund (Don and Harrison 2006).

Second, to enhance the quality of deal flow, it is suggested that a web based system be created for entrepreneurs to submit business plans for potential angel funding. Utilizing the resources of university business schools, students would provide initial screening and due diligence for the proposals and complete a short assessment of the investment opportunity. This assessment would be available to business angels to help manage deal flow and also available to entrepreneurs as a timely feedback mechanism in their search for equity capital. Funds for this web based screening system can be garnered from a small management fee that is part of the Archimedes Fund and government support.